SOLOMON HESS Capital Management | CRA news

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CRA Modernization: Regulators Commit to Joint Rulemaking

The announcement to propose rescinding the OCC's 2020 Final Rule came on the heels of Michael Hsu assuming the role of Acting Comptroller of the Currency on May 10. Hsu previously served in the Division of Supervision and Regulation at the Federal Reserve Board. Left, Hsu.

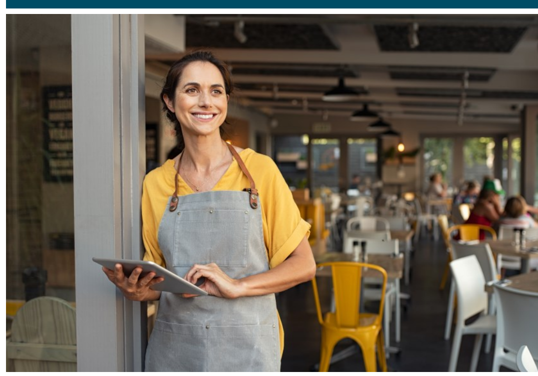
Stakeholders of the Community Reinvestment Act (CRA) applauded the news on July 20 when the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FED), and the Federal Deposit Insurance Company (FDIC), collectively the Agencies, released an interagency statement publicly committing to working jointly to strengthen and modernize regulations implementing the CRA. "Joint agency action will best achieve a consistent, modernized framework across all banks to help meet the credit needs of the communities in which they do business, including low and moderate income (LMI) neighborhoods," the Agencies stated. *(continued on page 3)*

Inside

CRA Community Development Asset: SBA 7(a) Loans

Excess liquidity in the banking sector and limited lower-risk investment opportunities have renewed bank interest in the Small Business Administration (SBA) 7(a) Program loan asset class as an attractive investment. This is because the guaranteed portion of 7(a) loans that are sold in the secondary market come with the full faith and credit government guarantee from the SBA, are primarily adjustable rate, and carry low risk weighting for capital purposes. Typically, banks acess this asset class via 7 (a) pool securities sourced from authorized pool assemblers for ease of investment and diversification of prepayment risks. Pool assemblers account for roughly 90% of 7(a) loans purchased in the secondary market. Some banks and non-bank investors, such as the Solomon Hess SBA Loan Fund (the Fund), acquire these loans not only for their investment characteristics but also for other characteristics which can make them eligible for CRA credit under community development. Borrower address, business type and jobs supported information are provided at the 7(a) loan level, which enables determination of whether a particular loan qualifies for CRA in a bank's target assessment area. While there is a robust and established secondary market for 7(a) loans, the un-securitized *(continued on page 2)*

SBA 7(a) Loan Profile: Stevenchloe LLC dba Hummus Republic, Fresno, CA



This loan was originated by the CDC Small Business Finance Corporation, a mission-driven lender. Proceeds of the loan were used to finance equipment to open the business. The restaurant is located in a low income census tract and a CDFI Fund Qualified Investment census tract, which should qualify this loan for CRA under community development. This loan should further qualify for CRA as a new business that promotes economic development. This is a Hispanic-owned and woman co-owned business. Left, a restaurant worker welcoming guests.

The SBA Loan Fund has been acquiring the guaranteed portion of SBA 7(a) loans in the secondary market for CRA-motivated bank investors since 2004. When portfolio managers at the SBA Loan Fund screen loans, they look for loans in specific investor-targeted counties or census tracts that meet not only the technical requirement of the CRA but also the spirit under which it was created. The SBA 7(a) loan to Stevenchloe LLC in Fresno is an example of the type of loan in the Fund's portfolio that is allocated to an investor.

Stevenchloe LLC operates a franchised Hummus Republic fast casual restaurant focused on creating accessibility to healthy food by providing convenient, and primarily plant-based meals. The variety of healthy options was what intrigued owners Chloe Cardoza and her fiancé Steven Martinez when they were looking to open their first business. *(continued on page 3)*

7(a) Loans *(from page 1)* nature of the asset which requires physical delivery settlement creates operational inefficiencies for new buyers or buyers not routinely active in the market. The SBA Loan Fund is a Community Development Entity (CDE) that has a long track record of acquiring and managing un-securitized 7(a) loans for community development-motivated investors and provides a turnkey opportunity for banks to benefit from targeted CRA. The Fund is triple-A rated (Aaa-bf) by Moody's Investor Services.

In a weekly lending report released by the SBA covering fiscal year to July 30, 2021, 7(a) loan volume reached $23.9 billion, 45% higher than in 2020 and 17% higher than 2017, when the agency guaranteed a record $25.4 billion of 7 (a) loans for the full fiscal year.

SBA 7(a) Program: The 7(a) guaranty program is the SBA's flagship program that supports small businesses. Its name comes from Section 7(a) of the Small Business Act of 1953 (P.L. 83-163, as amended). These are loans to help small business owners that might not otherwise qualify for conventional financing, cap out at $5 million and have low interest rates and long repayment terms. The loans can be used to finance working capital, business expansions and purchases of new businesses. Typically, 75% of the loan is guaranteed by the SBA as to payment of principal plus accrued interest to create incentives for banks to originate these loans. Authorized lenders may sell the guaranteed portion of the loans in the secondary market to source liquidity and book profits on the premiums associated with the sale. The recent boom in 7(a) lending resulted from program enhancements enacted in response to the COVID-19 pandemic, which included an increase to 90% of the loan being guaranteed, fee waivers and funds provided to pay principal and interest for both existing and new 7(a) loans for a period of six months. These enhancements are scheduled to sunset on September 30, though there is optimism that the program will continue to remain strong for the rest of the year.

CRA Community Development: Interagency Q&A Regarding Community Reinvestments dated March 11, 2012 (the Q&A) makes it clear, at Section __.12(g)(3)-1, that to be considered as community development, an activity must meet both a size and purpose test. For the size test, per CFR 25.12(g), activities that promote economic development include "financing businesses or farms that meet the size eligibility of the Small Business Development Company (SBDC) or Small Business Investment Company (SBIC) programs or have gross annual revenues of $1 million or less." Because SBA loans follow the same size standards of SBIC programs outlined in §121.201 and codified at 13 CFR 107.70, generally all 7 (a) loans meet the size test for community development. However, not all 7(a) loans meet the purpose test, which must demonstrate that the activity promotes economic development by supporting permanent job creation, retention and/or improvements for persons who are currently LMI or supports permanent job creation, retention, and/or improvement in either LMI geographies, or in areas targeted for redevelopment by Federal, state, local or tribal government. Solomon Hess estimates that approximately 10% of originated 7(a) loans are sold in the secondary market and qualify for CRA under community development.

Solomon Hess SBA Loan Fund: The Fund has been an active investor in the 7 (a) secondary market, having invested over $2 billion to acquire almost 4,500 loans. The Fund offers CRA-motivated bank investors access to targeted CRA credit through the 7(a) loan asset class. The competitive advantages of the SBA Loan Fund have been built upon its 15-year track record of managing 7(a) loans for CRA and include experience sourcing, selecting and portfolio construction as well as operational and execution efficiencies. As of June 30, 2021, the SBA Loan Fund had over $500 million in equity from over 125 CRA-motivated investors nationwide. All investors have received the expected consideration for CRA from all three regulators since inception. Past performance is no indicator of future success and future success is not guaranteed. To learn more, please visit www.SolomonHess.com. ■

SBA Loan Fund Impact Metrics
as of June 30, 2021

JOBS SUPPORTED
20,443 jobs

DISTRESSED COMMUNITIES
1,021 loans

WOMAN OWNED BUSINESS
282 loans

MINORITY OWNED BUSINESS
245 loans

VETERAN OWNED BUSINESS
26 loans

MISSION-DRIVEN LENDER ORIGINATED
102 loans

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Joint Rulemaking *(from page 1)* In a separate statement on the same day, the OCC announced it will propose to rescind the agency's May 2020 Final Rule on CRA that became effective on October 1, 2020, but with the earliest compliance date of January 1, 2023. Acting Comptroller of the Currency Hsu stated that adoption of the Final Rule was a "false start."

Both announcements were met with support and optimism by CRA stakeholders, including banks and community advocates, who had been persistent in calling for a unified approach to the regulation of the CRA since the OCC's unprecedented move to seek comment and release guidance on CRA without the support of either the FDIC or the FED beginning in August 2018. While there was some strong support for elements of the OCC's Final Rule, its overall reception was hampered by its lack of interagency backing.

The Agencies stopped short of providing a timeline or detailed next steps, which are complicated by the need for the OCC to rescind its Final Rule as parts of its framework are already in effect for some banks. Under the Administrative Procedure Act, the OCC will need to propose a replacement at the same time it rescinds its rule to avoid creating a regulatory vacuum.

Representatives from both the OCC and the FED have separately said that this second attempt to reform the CRA will build upon the Advanced Notice of Proposed Rulemaking (ANPR) issued by the FED last September, which was overall positively received. "We are delighted to work together to develop a joint Notice of Proposed Rulemaking (NPR) building on the Board's September 2020 ANPR, which was intended to provide a framework for a joint rulemaking to ensure that the CRA remains a strong and effective tool to address inequities in access to credit and meet the needs of LMI communities and garners broad support," FED Governor Lael Brainard said in a press release dated July 20. Brainard has spearheaded the FED's work in CRA modernization. Acting Comptroller of the Currency Hsu said in a separate statement that he looked forward to working with the other agencies and "building on the ANPR proposed by the FED." A formal joint proposal is not expected for several more months, likely not until 2022. ■

Congresswoman Maxine Waters (D-CA), Chairwoman of the House Committee on Financial Services, on July 22 released a statement that said, "I look forward to working with [the Agencies] as they develop a new proposed rule that should strengthen the CRA's application." Left, Waters.

Stevenchloe *(from page 1)* The process to open the restaurant was more difficult than the couple had anticipated. Cardoza and Martinez signed the property lease in November 2019 and when they were ready to begin tenant improvements, they could not find a lender in March 2020, as the COVID-19 pandemic struck resulting in mandatory shut downs. The couple was lucky that their landlord was very accommodating, allowing them the time to wait a few months before reapplying for financing. They were approved for a 7 (a) loan in December 2020 and were able to open the restaurant the following April.

The business is located in a low income census tract in Fresno and the owners self -reported to the SBA that this loan supported the creation of four jobs. ■

Did you know? **SBA 7(a) loans to new businesses qualify under community development. Q&A section__12.(g)(3)-1 provides that a community development activity meets the "purpose" test to promote community development if, among other things, the activity involves financing recently formed small businesses.**

The SBA 7(a) loan to Read Academy of Sacramento is another example of the type of loan in the SBA Loan Fund portfolio. Read Academy is a tuition-based school for students with special learning needs such as dyslexia, dysgraphia, and dyscalculia. The school empowers students in grades two to eight to excel in their academic skills by providing instructions developed to suit their unique learning styles. Founder Leah Skinner, M.Ed., is a Certified Special Education Advocate committed to helping parents navigate the world of dyslexia. She has three sons who are dyslexic. Skinner established the school in 2017.

This loan was originated by the CDC Small Business Finance Corporation. Proceeds of the loan were used to finance equipment. The borrower is located in a low income census tract and a CDFI Fund Qualified Investment census tract and supported the creation of eight jobs and the retention of eight jobs. This is a woman co-owned business that is focused on children's welfare, including education.

SBA Loan Fund Supports Mission-Driven Lenders

The SBA Loan Fund has a primary mission of promoting permanent job creation, retention, and/or improvement for LMI persons who are employed by small businesses by creating greater financial liquidity and a lower cost of capital within the SBA 7(a) secondary market. The Fund has made a commitment to sourcing 7(a) loans from authorized 7(a) lenders that are also mission-driven lenders, such as Certified Development Companies (CDCs) and Community Development Financial Institutions (CDFIs), where possible. By acquiring loans from organizations with missions aligned with that of the Fund, greater liquidity is provided, which results in more loans originated to support end borrowers most in need. The two loans profiled in this edition of **CRA***news* were originated by the CDC Small Business Finance Corporation, a leader in community development lending dedicated to serving underserved and economically disenfranchised markets. In 2020, the organization provided over $370 million in small business financing, over 70% of which was to entrepreneurs of color, women and military Veterans. ■

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SBA Loan Fund Impact: Supporting Community Development

Since inception in 2004, the Solomon Hess SBA Loan Fund has invested over $2.4 billion in small business loans. These loans, made to over 4,400 small businesses located in 47 states, have helped to create and/or retain over 65,000 jobs. Over 70% of the loans in which we have invested are located in low and moderate income or otherwise economically distressed census tracts. The majority of these loans are made to under-served small businesses that do not have access to conventional commercial debt.

Managing Good Capital Well

Solomon Hess Capital Management ("Solomon Hess") is an alternative asset manager specializing in fixed income. Our mission is to provide investors with community and economic development-focused investment funds that generate both competitive risk-adjusted returns and positive quantifiable community impact. Founded in 2004 and located in Falls Church, Virginia, Solomon Hess has over $750 million of assets under management. Solomon Hess is Fund Manager to the SBA Loan Fund and investors include banking institutions of all sizes that are seeking Community Development Investment or Lending test credit within the Community Reinvestment Act (CRA) rules via exposure to SBA 7 (a) loans and related assets. Other investment opportunities with Solomon Hess include investing in our Absolute Return strategy. We offer our strategies as funds or separate accounts.

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